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November 22, 2002

By ECFS

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
TW-B204
Washington, DC 20554

Re: ***Ex parte***
WC Docket No. 02-314: Application of Qwest Communications International, Inc. To Provide In-Region, InterLATA Services in the States of Colorado, Idaho, Iowa, Montana, Nebraska, North Dakota, Utah, Washington and Wyoming

Dear Ms. Dortch:

On behalf of Touch America, the purpose of this letter is to bring to the Commission's attention certain material matters that have occurred since the filing of comments and reply comments in this proceeding that bear directly on issues before the Commission, namely, continuing and mounting accounting revelations from Qwest as well as a recent ruling by the Colorado Public Utility Commission ("CPUC") that clearly demonstrates that the record in this matter is incomplete.

Accounting Revelations

Beginning with its October 28th announcement about its accounting policies and procedures for optical capacity sales up to and including its November 14th 8K filing before the Securities and Exchange Commission ("SEC"), Qwest continues to not only unwittingly admit that it has been and is violating section 271 of the 1996 Telecommunications Act ("Act"), but to also confirm that its accounting troubles – and inability to meet Generally Accepted Accounting Principles ("GAAP") – are systemic and that its efforts to identify and fix such troubles far from complete.

On October 28th, Qwest announced that it has completed its analysis of its "revenue recognition and accounting treatment for sales of optical capacity assets" and has concluded that "for accounting purposes it will treat [such sales] for cash as operating leases and recognize the revenue from these assets over the life of the IRU." [1] Nevertheless, Qwest attempts to hold out its "lit capacity IRU agreements" as "sales of assets" that fall outside of section 271.[2] The Commission, however, has clearly pronounced that "the leasing of capacity on an in-region, interLATA network is plainly an in-region, interLATA service."[3] That is, under Commission precedent, the lease of capacity is a telecommunications service, not an asset, and, to the extent the lease involves in-region, interLATA capacity, it violates section 271.[4] Accordingly, as "operating leases," Qwest is providing prohibited in-region, interLATA services through so-called "lit capacity IRU agreements."[5]

Qwest's optical capacity transactions are only one example of its accounting problems. Indeed, Qwest's accounting problems and the questions surrounding those problems continue to mount. In its November 14th 8K filing before the SEC, for instance, Qwest reported that it had discovered additional accounting errors of approximately $358 million pertaining to design service costs and deferred commissions.[6] Even then, however, Qwest warned that the adjustments are subject to audit and, as such, it could "give no assurance that the adjustments are final, nor [sic] that all such aggregate adjustments necessary to present [its] financial statements in accordance with generally accepted accounting principles ('GAAP') have been identified."[7]

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1 *See, e.g.,* "Qwest Communications Updates Status of Certain Accounting Matters: Company Announces the Completion of its Analysis of Accounting Policies and Practices as they Relate to Revenue Recognition and Accounting Treatment for Sales of Optical Capacity Assets" at 1 (Oct. 28, 2002).

2 *See, e.g.,* Supplemental Reply Comments of Qwest Communications International Inc., WC Docket No. 02-314, at 68, n. 74 (filed Oct. 25, 2002).

3 *See In the Matter of Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934, as Amended*, CC Docket No. 96-149, 12 FCC Rcd. 8653, 8682 (1997).

4 As recognized by the Commission, this finding follows from the statutory definition of "interLATA services;" *i.e.*, an "interLATA service" is defined under the Act as "telecommunications," which, in turn, is defined as "transmission." 12 FCC Rcd. at 8682-83, n. 110. Similarly, Qwest's "lit capacity IRU" agreements specifically define the leased "capacity" as a "transmission" using a given portion of Qwest's network "designed to transmit digital signals."

5 Qwest cannot be heard to hide behind the Financial Accounting Standards Board's Statement of Financial Accounting Standards ("FAS") No. 13, *Accounting for Leases*. FAS No. 13 defines a "lease" as an agreement conveying the right to use property, plant and equipment for a period of time, but excludes agreements that are contracts for services "that do not transfer the right to use property, plant or equipment from one contracting party to the other." In this instance, Qwest clearly transfers "the right to use" to the customer. Since the definition of leases excludes only service contracts that do *not* transfer the right to use property, plant or equipment, it follows that a service contract that *does* transfer the right to use may still be a lease. In other words, a lease can clearly be a service or an asset. In this instance, it is a service.

6 *See* Qwest Communications International Form 8K at 4 (Nov. 14, 2002) ("Qwest 8K"). *See also The Wall Street Journal,* Nov. 18, 2002 at B4.

7 Qwest 8K at 1. *See also* Qwest Communications International Inc., Notification of Late Filing, SEC File No. 000-22609 (Nov. 14, 2002).

Thus, Qwest also warned that once it completes its "analyses of other accounting policies and practices and [its] review of internal controls," it expects that "further adjustments may required" which will result in additional restatements.[8]

Secret Agreements

In addition to the findings of the Minnesota Public Utilities Commission described at length in Touch America's Reply in this matter,[9] the CPUC recently rejected a number of Qwest's secret agreements – the filing of which Qwest has touted as evidence of compliance with section 252 of the Act – as contrary to public policy.[10] Specifically, the CPUC rejected seven of the secret agreements because, among other things, they contained an arrangement between Qwest and a CLEC whereby the CLEC would withdraw from the U S WEST/Qwest merger proceeding or a Qwest 271 proceeding.[11] The CPUC found such arrangements to be contrary to public policy because "agreements not to participate in [these proceedings of general applicability] – often settling issues collateral to those general proceedings – preclude the [CPUC] from receiving the relevant information to decide in those dockets."[12] As made clear by the CPUC's order, therefore, and as stated by Touch America throughout this proceeding, this Commission has not been presented with all of the relevant information necessary to make a decision in this docket.

Conclusions and Remedies

As a result of its premature offering of prohibited in-region, interLATA services, Qwest's 271 Application must be denied.[13] The Commission must not permit Qwest to profit from its

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8 Qwest 8K at 4.

9 Reply Comments of Touch America, WC Docket No. 02-314, at 14-15 (filed Oct. 25, 2002).

10 *See In the Matter of the Petition of MFS Communications Company, Inc. for Arbitration Pursuant to 47 U.S.C. § 252(B) of Interconnection Rates, Terms and Conditions with U S WEST Communications, Inc*., Docket No. 96A-287T, Order Denying Certain Amendments to Interconnection Agreements and Granting Certain Amendments, Decision No. C02-1295 (issued Nov. 13, 2002).

11 *Id*. at 11-12.

12 *Id.* at 12, n. 6.

13 *See In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan*, CC Docket No. 97-137, 12 FCC Rcd. 20543, ¶ 397 (1997)("evidence that a BOC has engaged in a pattern of discriminatory conduct or disobeying federal and state telecommunications regulations would tend to undermine our confidence that the BOC's local market is, or will remain, open to competition once the BOC has received interLATA authority"); *In the Matter of the Applications of TeleSTAR, Inc. For Authority to Construct New Common Carrier Point-to-Point Microwave Radio Stations*, File Nos. 1743 CF-P-85 through 1757 CF-P-85, 2 FCC Rcd. 5, ¶¶ 30-35 (1987)(refusing a license to a company that concealed the fact that it started building towers for microwave transmission before the agency had approved their construction); *In Re the Applications of Liberty Cable Co., Inc. for Private Operational Fixed Microwave Service Authorization and Modifications*, WT Docket No. 96-41, 15 FCC Rcd. 25050, ¶¶ 12-41 (2000)(denying an application for private operational fixed microwave service ("OFS") facilities where the applicant

wrongdoing, *i.e.*, receive the benefit from the very statute that it has been violating. At minimum, Qwest must be required to divest itself of its in-region, interLATA assets and customers prior to being permitted to provide in-region, interLATA services. Only then can the Commission meet section 271's goal of a level playing field. Fines and penalties are insufficient. Rather than correct the competitive effects of Qwest's actions, fines and penalties merely fill the coffers of the U.S. Treasury and send a signal to the marketplace that a company can violate the law with the understanding that, if caught, it may only have its hands slapped with fines or penalties which merely becomes a cost of doing business.

Further, the fact that Qwest continues to be riddled with accounting problems makes clear that Qwest is unable at this time to demonstrate with any credibility that all of its corporate entities, including its 272 affiliate, Qwest Long Distance Corp., and it Bell operating company, Qwest Corp., are GAAP compliant as required by section 272.[14] The Commission must therefore wait until the investigations into Qwest's accounting policies, practices, procedures, guidelines and controls are completed and any resulting changes are properly implemented, before ruling in this matter. If this process cannot be completed until after the statutory deadline by which to act on Qwest's Application, the Commission has no choice but to reject it.[15]

The Application also must be rejected because the Commission would otherwise be acting on an incomplete record. Because parties have been silenced by Qwest's secret agreements, the Commission has been prevented from reviewing all the relevant facts and, the facts that are in the record, are skewed by the discriminatory provisions of those agreements.

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was prematurely providing OFS service without prior authorization and misrepresented its operations to the Commission).

[14] In other words, and as stated by Touch America in its Reply (*supra*, n. 9 at 7-9), Qwest's claim that its 272 affiliate, Qwest Long Distance Corp., is somehow not tainted with Qwest's accounting ills defies belief because Qwest does not yet know the extent of those ills. On the other hand, if it is applying new accounting policies, procedures, guidelines and controls to the affiliate, why not apply them to all of its companies instead of continually stating before the SEC that it cannot yet vouch for its financials. In any event, its Bell operating company, Qwest Corp. is clearly tainted with Qwest's accounting problems. It should also be mentioned that although Qwest at times seems to suggest that its financials before the SEC are different than the financials before the Commission or required by section 272, GAAP is GAAP. Its books and the books of its 272 affiliate and Bell operating company are either GAAP compliant or they are not. At this point in time, and by Qwest's constant admissions and revelations, neither is GAAP compliant.

[15] Given the investigations by the SEC and the Department of Justice, as well as the Chairman's position on the President's Corporate Fraud Task Force, it is difficult to see how the Commission can do anything else. Accounting is as much a part of 271 as are the 14-point checklist items and the public interest. The Act is very clear: 271 authority cannot be granted absent compliance with the accounting requirements of section 272. 47 U.S.C. §271(d)(3)(B).

On public policy grounds alone, much less the need for a full and complete investigation into the secret agreements issue, the Commission must reject the Application for failure to have a complete record in this proceeding and its resulting inability to ascertain the full effect of the secret agreements on competition in the 9-state region.

Respectfully submitted,

Davis Wright Tremaine LLP

/s/

Randall B. Lowe
Counsel for Touch America, Inc.

cc: Commissioner Powell (by hand)
Commissioner Abernathy (by hand)
Commissioner Copps (by hand)
Commissioner Martin (by hand)
Christopher Libertelli (by hand)
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